No. 311

In the Supreme Court of the United States

OCTOBER TERM, 1957

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

JEAN F. STERN, TRANSFEREE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE PETITIONER

J. LEE RANKIN,
Solicitor General,
CHARLES K. RICE,
Assistant Attorney General,
JOHN F. DAVIS,
Assistant to the Solicitor General,
A. F. PRESCOTT,
KENNETH E. LEVIN,
Attorneys,
Department of Justice, Washington 25, D. C.

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OPINIONS BELOW

The memorandum opinion of the Tax Court (R. 14–16) is not officially reported. The opinion of the Court of Appeals (R. 17–26) is reported at 242 F. 2d 322.

JURISDICTION

The judgment of the Court of Appeals was entered on February 26, 1957 (R. 16–17). On May 23, 1957, by order of Mr. Justice Burton, the time for filing a petition for certiorari on behalf of the Commissioner was extended to and including July 26, 1957 (R. 26). The Commissioner's petition for certiorari was filed on July 25, 1957, and was granted on October 14, 1957

(R. 27). The jurisdiction of this Court rests upon 28 U. S. C. 1254.

QUESTION PRESENTED

Whether, for purposes of collecting federal income taxes, the beneficiary of life insurance policies, in which the decedent had retained the right to change the beneficiary and to draw the cash surrender value, is to be treated as a transferee (1) of the entire proceeds of the policies, or, alternatively, (2) of the cash surrender values.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are: Sections 311 (a) and (f), 811 (g), 827 (b), 900 (a) and (e) and 3670 of the Internal Revenue Code of 1939; Section 316 of the Revenue Act of 1926; Sections 297.140 (1), 297.140 (2), 297.140 (3), 297.150 (1) and 297.150 (2) of the Kentucky Revised Statutes; Section 81.27 of Treasury Regulations 105; and Section 29.311-1 of Treasury Regulations 111. They are set forth in the Appendix, *infra*, pp. 42–49.

STATEMENT

Dr. Milton J. Stern died on June 12, 1949 (R. 11). At the time of his death, Dr. Stern was carrying seventeen policies of insurance on his life, of which Jean F. Stern, his wife and respondent here, was the beneficiary. The following chart indicates, as to each policy, the date of issuance, face amount, date respondent was named beneficiary, cash surrender value, and the value of the proceeds received or to be received by the beneficiary on the insured's death (R. 12–13):

Issued Date	Life Ins. Company	Policy Number	Face Amount	Date Petr. Named Beneficiary	Cash Surrender Value at Date of Death	Value of Proceeds at Date of Death
7-26-30	Pacific Mutual	765279	$5,000.00	7-26-30	$1,685.00	*$5,001.65
12-26-29	Pacific Mutual	743985	1,000.00	12-26-29	625.35	*1,000.55
9-30-11	Northwestern Mutual	895969	5,000.00	3-13-19	2,401.90	*5,000.00
9- 9-15	Northwestern Mutual	1110950	5,000.00	3-13-19	2,321.00	**4,034.65
3-20-19	Northwestern Mutual	1196991	5,000.00	3-20-19	2,362.05	**4,034.65
3-20-19	Northwestern Mutual	1196992	5,000.00	3-20-19	2,362.05	**4,034.65
5-18-23	Northwestern Mutual	1656464	1,000.00	5-18-23	439.93	*980.59
10- 6-28	Northwestern Mutual	21112085	3,000.00	7-11-34	1,180.89	**2,420.79
9-29-32	Northwestern Mutual	2438131	3,000.00	7-11-34	1,007.82	**2,420.79
6-30-32	Provident Mutual	690009	2,000.00	6-30-32	669.06	*2,019.64
4-24-31	Massachusetts Mut	1007342	6,755.00	4-24-31	3,608.10	*5,200.00
4-25-34	Mut. Ben. of Newark	1629792	2,500.00	5- 7-34	881.18	**1,500.00
10- 5-28	Mut. Ben. of Newark	1367521	10,000.00	5-26-34	5,602.67	**3,625.00 [1]
9- 2-21	Mut. Life of N. Y	2940373	1,500.00	9- 2-21	643.71	*1,491.97
11- 4-35	Mut. Ben. of Newark	1702801	1,000.00	11-18-39	334.79	*1,010.93
7-10-33	Mut. Ben. of Newark	1594749	2,500.00	7-10-33	837.18	*2,506.18
1- 6-34	Bus. Men's Assur. Co	185314	1,000.00	1- 6-34	297.00	*1,000.00
	Totals				$27,259.68	$47,282.02

*Cash proceeds.

**Present value at date of death of future payments.

Dr. Stern retained the right to change the beneficiary and to draw the cash surrender value of each of the above policies (R. 14).

In separate litigation, Dr. Stern was held liable for income tax deficiencies and fraud penalties for the years 1944 through 1947 (*Stern* v. *Commissioner*, decided February 15, 1955 (1955 P-H T. C. Memorandum Decisions, par. 55,040)) as follows (R. 11–12):

Taxable Years	Net Income Determined	Income Tax Deficiency	Sec. 293 (b) Penalty
1944	$17,384.01	$4,675.74	$2,337.87
1945	21,604.28	6,470.01	3,235.01
1946	22,864.43	6,645.70	3,322.85
1947	20,427.35	3,885.27	2,205.06

[1] On this policy either the cash surrender value or the value of the proceeds appears to be in error since it is not logical for the surrender value to be greater than the proceeds. However, the figures appear in the record as they do above.

These liabilities totaling $32,777.51 have not been paid, and the assets of Dr. Stern's estate are not sufficient to satisfy them (R. 12).

At the time of his death, Dr. Stern owned the following assets except the two items marked with an asterisk (R. 14):

Stocks		$3,468.15
U. S. Treasury Bonds*		7,800.00
Cash on deposit, First National Bank & Trust Co., Lexington, Ky	$1,313.70	
Cash in safe	723.00	
		2,036.70
Real estate:*		
Farm of 10 acres, with improvements	21,000.00	
Residence, Dantzler Court, Lexington, Ky	15,000.00	
		36,000.00
Miscellaneous:		
Household furniture	4,921.25	
1 Cow	140.00	
Account Receivable	3,000.00	
Office Equipment	1,200.00	
Ford Automobile	900.00	
Optical Rebate Receivable	648.24	
		10,809.49
		$60,114.34

*The U. S. Treasury Bonds and real estate were held in joint titles with right of survivorship by Dr. Milton J. Stern and petitioner.

No distributions from decedent's estate had been made to Mrs. Stern at the time of the stipulation (R. 14).

On August 17, 1953, the Commissioner sent a deficiency letter to Mrs. Stern asserting that she was liable for Dr. Stern's unpaid income tax deficiencies, fraud penalties, and interest as transferee of his estate (R. 4–6). Mrs. Stern petitioned the Tax Court for redetermination of this asserted liability on November 16, 1953 (R. 2–3). The Tax Court held that as beneficiary of Dr. Stern's life insurance policies, Mrs. Stern was liable as transferee of his estate to the extent asserted by the Commissioner, together with interest as provided by law (R. 14–16).

The Court of Appeals reversed, holding that Mrs. Stern was not liable as transferee either of the proceeds or cash surrender value of the insurance policies (R. 17–26).

SUMMARY OF ARGUMENT

I

Under Section 311 of the Internal Revenue Code of 1939, the Commissioner is authorized to collect on an existing liability "at law or in equity" from a transferee in the same manner as he may from the original taxpayer. Transferee liability in equity arises from the transfer of assets without adequate consideration, either while the transferor is insolvent or resulting in his insolvency and inability to pay his debts. Here Dr. Stern died leaving an insolvent estate which was unable to pay his delinquent income taxes. The Government's position, which was sustained by the Tax Court, is that, because the insured decedent retained the right until his death to change the beneficiary of his life insurance policies, and could therefore have made his estate the beneficiary, his designation of his wife as beneficiary, coupled with the non-exercise of right to designate his estate as beneficiary, made her the transferee of the entire proceeds of the policies, and liable as such to that extent for decedent's delinquent income taxes. The proceeds of the policies constituted *his* assets, available for payment of his debts including the unpaid federal income taxes, and these assets were transferred to her upon his death.

We submit that the Court of Appeals erred in holding that the proceeds of decedent's insurance policies were never his property, and that they were

not transferred to his beneficiary when he died. In upholding the constitutionality of the estate tax as applied to the proceeds of life insurance, this Court held that a transfer of the proceeds occurs upon the death of the insured, and that the taxable estate includes property procured through expenditures by the decedent with the purpose, effected at his death, of having it pass to another. *Chase National Bank* v. *United States*, 278 U. S. 327. It would be illogical and unrealistic to hold that a "transfer" of insurance proceeds from the insured to the beneficiary takes place for estate tax purposes, but not for income tax purposes, upon the insured's death. On the contrary, the terms and history of the pertinent statutory provisions show that, under both the estate and the income tax laws, the insured's death operates as a transfer of the proceeds of the policies to the beneficiary, where during his lifetime the insured retained any incident of ownership such as the right to change the beneficiary or to draw upon the cash surrender value.

The statutory right to proceed against "transferees" came into the income and estate tax law at the same time in the Revenue Act of 1926, c. 27, 44 Stat. 9. By a combination of later statutory provisions, the term as used with respect to the estate tax was made specifically applicable to the beneficiary of life insurance proceeds if the insured possessed at his death any of the incidents of ownership of the policy, such as the right to change the beneficiary or to draw the cash surrender value. The legislative history of the Revenue Act of 1926 indicates that "transferee" originally meant the same with respect to both the estate and income taxes. The legislative history of

the later statutory provisions with respect to the estate tax shows that they were merely intended to make the term "transferee" more specific, without altering its previous meaning. The term is, therefore, to be construed in the same way as to both the estate and income tax; and since it is clear that a beneficiary may be liable as a transferee of the proceeds of insurance for estate tax purposes, in such circumstances he should also be treated as a transferee of the proceeds for income tax purposes.

The fact that, while the insured lives, the beneficiary acquires no vested rights, but only an expectancy, also shows that the transfer must occur upon the death of the insured. Moreover, in a bankruptcy context, this Court has denied significance to the distinction between a policy payable to the insured's estate, the proceeds of which are clearly subject to the payment of decedent's delinquent income taxes, and one which, although payable to a named beneficiary, could, by reason of the insured's retention of the right to change the beneficiary, have been made payable to the insured's estate. *Cohen* v. *Samuels*, 245 U. S. 50.

II

Alternatively, regardless of whether there is a transfer of the entire proceeds, we submit that the beneficiary is a transferee of the cash surrender values of the policies. This Court and others have often explained that for practical purposes the surrender values are the property of the insured while he lives. *New York Life Ins. Co.* v. *Statham*, 93 U. S. 24. Insurance companies actually lay aside and invest a re-

serve fund equal to the surrender value, to be appropriated to the payment of the policy when it falls due. Clearly this value may be reached by the Government to satisfy tax liabilities of the insured while he lives. Several courts of appeals have held that to view the death of the insured as wiping out the surrender values would be unrealistic; rather upon his death they merely cease to be payable to him and merge in the proceeds which are payable to the beneficiary. The court below stands alone in its view that the cash surrender values are not assets of the insured while he lives and that as to them, the beneficiary is not a transferee upon the death of the insured. If the insured had honestly reported his income, or if his fraud had been established prior to his death, these surrender values could have been reached to satisfy his deficiencies and penalties. There is no inequity in depriving his estate of a tax advantage arising solely from the fortuitous combination of his fraud and death before payment of taxes.

III

The holding of the court below that the liability of the transferee was limited by state law is erroneous. In upholding the constitutionality of the transferee provisions of the Revenue Act of 1926, this Court reserved decision on that point. *Phillips* v. *Commissioner*, 283 U. S. 589. Since then several courts of appeals have taken the position that the transferee liability of the beneficiary of life insurance policies for the delinquent income taxes of the insured may be limited by state law. On the other hand, the Court of

Appeals for the Third Circuit has twice held that the need for uniformity of decision in this field requires resort to the general law as declared by federal courts.

Essentially the Government is here seeking to collect a federal income tax. The ultimate liability has been fixed by Congress, and a transferee has been held by this Court to be a taxpayer. *United States* v. *Updike*, 281 U. S. 489. Prior to the Revenue Act of 1926, the Government could recover against transferees only by resorting to a proceeding in equity under the general equitable principle of the trust fund doctrine. Section 280 of the 1926 Act, which became Section 311 of the 1939 Code, did not establish any new transferee liability, but merely authorized the Commissioner to utilize against transferees the same summary collection procedures available against other taxpayers. He could still proceed in a court of equity if he desired. But regardless of the procedure chosen, whether transferee liability exists must be determined as a matter of federal law to achieve uniformity of application throughout the country and to avoid differences in result in identical situations depending on differences in local law. The legislative history of the Revenue Act of 1926 indicates that, by including Section 280, Congress anticipated that uniformity of precedents would be developed in this area by the Board of Tax Appeals.

At all events, the Kentucky statutes held by the court below to limit transferee liability here are exemption provisions and hence not applicable to a proceeding for the collection of federal income taxes. State exemption provisions are not laws applicable to

the United States unless made so by Congress itself. *Fink* v. *O'Neil*, 106 U. S. 272. Congress did make them applicable to bankruptcy, but not to the collection of taxes.

ARGUMENT

I

FOR THE PURPOSE OF COLLECTING FEDERAL INCOME TAXES, THE BENEFICIARY OF LIFE INSURANCE POLICIES OF WHICH THE INSURED RETAINED THE RIGHT TO CHANGE THE BENEFICIARY IS A TRANSFEREE OF THE PROCEEDS OF THE POLICIES

Section 311 of the Internal Revenue Code of 1939 authorizes the Commissioner to collect on an existing liability "at law or in equity" from a transferee in the same manner as he may from the original taxpayer. Under federal law, transferee liability in equity arises upon the transfer of assets without adequate consideration, either while the transferor is insolvent or resulting in his insolvency and inability to pay his debts. *United States* v. *Hoper*, 242 F. 2d 468 (C. A. 7); 9 Mertens, *Law of Federal Income Taxation*, Section 53.12. In the case at bar, there is no question that the estate of Dr. Stern had insufficient assets to meet its liabilities. The stipulation provides that his income tax liability was litigated and deficiencies and penalties established for the years 1944 through 1947 in the Tax Court (*Stern* v. *Commissioner*, decided February 15, 1955 (1955 P-H T. C. Memorandum Decisions, par. 55,040)) in the total amount of

$32,777.51; that this liability has not been satisfied; and that the assets of his estate are insufficient to satisfy it (R. 11–12). It was, of course, a liability of the insured on June 12, 1949, the day he died, even though not asserted by the Commissioner or judicially determined by the Tax Court until later. *United States* v. *Gilmore*, 222 F. 2d 167 (C. A. 5), certiorari denied, 350 U. S. 843.

The Tax Court held that, because the insured decedent retained the right to change the beneficiary of his policies and could therefore have made his estate the beneficiary, the naming and retention of respondent as the named beneficiary constituted, as of the time of his death, a transfer of the proceeds to her making her liable as a transferee. The Court of Appeals reversed, and held, *inter alia*, that the respondent was not a transferee of the proceeds, citing its prior *per curiam* decision in *Tyson* v. *Commissioner*, 212 F. 2d 16, and *Rowen* v. *Commissioner*, 215 F. 2d 641 (C. A. 2). These cases support this holding of the Court of Appeals, as do also the cases of *United States* v. *New*, 217 F. 2d 166 (C. A. 7); *United States* v. *Truax*, 223 F. 2d 229 (C. A. 5); and *United States* v. *Bess*, 243 F. 2d 675 (C. A. 3), certiorari granted, October 28, 1957. Meanwhile the Tax Court, however, has consistently held in numerous cases that under the circumstances here a beneficiary is a transferee of the proceeds. *Muller* v. *Commissioner*, 10 T. C. 678; *Neely* v. *Commissioner*, decided August 10, 1949 (1949 P-H T. C. Memorandum Decisions, par. 49,188); *Sullivan* v. *Commissioner*, decided January 11, 1950 (1950 P-H T. C. Memorandum Deci-

sions, par. 50,000); *Leary* v. *Commissioner,* 18 T. C. 139; *Rowen* v. *Commissioner,* 18 T. C. 874, reversed, 215 F. 2d 641 (C. A. 2); *Tyson* v. *Commissioner,* decided June 5, 1953 (1953 P-H T. C. Memorandum Decisions, par. 53,198), reversed *per curiam,* 212 F. 2d 16 (C. A. 6); *Bales* v. *Commissioner,* 22 T. C. 355; *Wendell* v. *Commissioner,* decided February 23, 1956 (1956 P-H T. C. Memorandum Decisions, par. 56,040); *Stoumen* v. *Commissioner,* 27 T. C. 1014, pending on appeal (C. A. 3). In the last named case, the Tax Court reconsidered the question thoroughly, noting its awareness of the appellate decisions to the contrary, and reasserted its prior position.

Essentially the position of these courts of appeals is that Section 311 of the 1939 Code (Appendix, *infra,* p. 42) provided a summary procedure for the enforcement of "the liability, at law or in equity, of a transferee of property of a taxpayer," and that the proceeds of an insurance policy are in no sense ever the property of the decedent.[2] The Tax Court,

[2] In *Rowen* v. *Commissioner, supra,* the Court of Appeals took the position (p. 644) that Section 311 "is directed against those to whom *assets* or *property* which belonged to the decedent and which, but for transfer, could have been distrained in his hands, have been transferred * * *." This appears to raise a plain inconsistency; for in the same opinion, the court held that, although she was not a transferee of the proceeds, the beneficiary was a transferee of the cash surrender values within the meaning of Section 311. Yet the court had previously held that cash surrender values are not distrainable in the hands of the insured (*United States* v. *Metropolitan Life Ins. Co.*, 130 F. 2d 149 (C. A. 2)), although clearly they may be reached by other means (*Knox* v. *Great West Life Assur. Co.*, 212 F. 2d 784 (C. A. 6); *United States v. Ison*, 67 F. Supp. 40 (S. D. N. Y.)).

on the other hand, concluded, in the light of related estate tax provisions and legislative history, that the insurance beneficiary was intended to be classed as a transferee.

In the leading case of *Chase Nat. Bank v. United States*, 278 U. S. 327, the validity of the estate tax law as applied to the proceeds of life insurance was attacked on the ground, *inter alia*, that it was a direct tax on property and void because not apportioned, rather than a tax upon the transfer of property as required by the statute. This Court held that the termination at death of the power of the decedent to change the beneficiaries of the life insurance policies which he had procured, and the consequent passing to the designated beneficiaries of all rights under the policies, freed from the possibility of the further exercise of this power, operated as an effective transfer of the proceeds and was the legitimate subject of a transfer tax for estate tax purposes. The Court said (p. 335):

> A power in the decedent to surrender and cancel the policies, to pledge them as security for loans and the power to dispose of them and their proceeds for his own benefit during his life which subjects them to the control of a bankruptcy court for the benefit of his creditors, *Cohen v. Samuels*, 245 U. S. 50 (see *Burlingham v. Crouse*, 228 U. S. 459), and which may, under local law applicable to the parties here, subject them in part to the payment of his debts, * * * is by no means the least substantial of the legal incidents of ownership, and its termination at his death so as to free

> the beneficiaries of the policy from the possibility of its exercise would seem to be no less a transfer within the reach of the taxing power than a transfer effected in other ways through death.

Rejecting the taxpayers' contention that the proceeds were not transferred to them from the decedent, but from the insurer, and hence that there was nothing to which a death transfer tax could apply, the Court said (pp. 337–338):

> Obviously, the word "transfer" in the statute, or the privilege which may constitutionally be taxed, cannot be taken in such a restricted sense as to refer only to the passing of particular items of property directly from the decedent to the transferee. It must, we think, at least include the transfer of property procured through expenditures by the decedent with the purpose, effected at his death, of having it pass to another. * * * Termination of the power of control at the time of death inures to the benefit of him who owns the property subject to the power and thus brings about, at death, the completion of that shifting of the economic benefits of property which is the real subject of the tax, just as effectively as would its exercise, which latter may be subjected to a privilege tax, * * *. *And the non-exercise of the power may be as much a disposition of property testamentary in nature as would be its exercise at death,* * * *. [Italics supplied.]

Since, where decedent retains incidents of ownership, the transfer occurs at death, the estate tax on the proceeds of life insurance is applicable even as to

policies issued prior to passage of the Act providing for the inclusion of the proceeds of policies payable to specific beneficiaries in the gross estate. *Heiner* v. *Grandin*, 44 F. 2d 141 (C. A. 3), affirmed on reargument, 56 F. 2d 1082, certiorari denied, 286 U. S. 561; *Cook* v. *Commissioner*, 66 F. 2d 995 (C. A. 3), certiorari denied, 291 U. S. 660; *Levy's Estate* v. *Commissioner*, 65 F. 2d 412 (C. A. 2). The situation is comparable to that in which the reservation by the settlor of the power to revoke a trust results in the inclusion of the trust corpus in the settlor's estate. Cf. *Reinecke* v. *Northern Trust Co.*, 278 U. S. 339.

It is true, as the Second Circuit pointed out in *Rowen* v. *Commissioner*, *supra*, that *Chase Nat. Bank* v. *United States*, *supra*, as well as the other cases cited, was not an income tax case. But the mere statement that only estate tax was involved does not make inapplicable here the broad rationale of the Court's ruling that the word "transfer" cannot be restricted to the passing of particular items of property directly from the decedent to the transferee, but also includes the transfer of property procured through expenditures by the decedent with the purpose, effected at his death, of having it pass to another. And, as the history of the statutory provisions shows, the word "transfer," which came into both the income and estate tax law in the same Revenue Act, has ~~the~~ same meaning with respect to both taxes.

Turning now to the specific statutory provisions involved, Section 900 (a) (1) of the 1939 Internal Revenue Code (Appendix, *infra*, p. 45) imposes liability upon a transferee of property of a decedent

in respect of the tax imposed under the estate tax chapter of the 1939 Code. Section 900 (e) (Appendix, *infra*, p. 45) defines the term "transferee" to include heir, legatee, devisee, and distributee, and to include a person who under Section 827 (b) (Appendix, *infra*, p. 44) is personally liable for any part of the estate tax. Section 827 (b) in turn imposes liability for the estate tax on a beneficiary who receives property included in the gross estate under Section 811 (g) (Appendix, *infra*, p. 43). Section 811 (g) provides that the gross estate shall include the proceeds of life insurance payable to beneficiaries of policies on the life of the decedent if the decedent possessed at his death any of the incidents of ownership of the policy. Section 81.27 of Treasury Regulations 105 (Appendix, *infra*, pp. 47–48) defines the phrase "incidents of ownership" as including, for example, disjunctively, the right of the insured or his estate to its economic benefits, the power to change the beneficiary, to surrender or cancel the policy, to assign it, to revoke an assignment, to pledge it for a loan, *or* to obtain from the insurer a loan against the surrender value of the policy. In view of these provisions, it is indisputable that the beneficiary of life insurance of a decedent, who retained until his death the right to change the beneficiary, is liable as a transferee of property of the decedent in respect of the estate tax.

Section 311 (a) (1) (Appendix, *infra*, p. 42) provides for summary collection from a transferee of property of a taxpayer in respect of the tax imposed under the income tax chapter of the 1939 Code. Sec-

tion 311 (f) (Appendix, *infra*, p. 42) defines the term "transferee" to include heir, legatee, devisee, and distributee. Section 29.311-1 of Treasury Regulations 111 (Appendix, *infra*, p. 49), as well as prior Regulations, broadened the definition of the term "transferee" so that it includes "all other classes of distributees." That definition has acquired the force of law. *Kieferdorf* v. *Commissioner*, 142 F. 2d 723 (C. A. 9), certiorari denied, 323 U. S. 733.

In *Rowen* v. *Commissioner*, 215 F. 2d 641 (C. A. 2), the Court of Appeals relied, to support its position that for purposes of income tax collection a beneficiary was not intended to be classed as a transferee as to the proceeds of an insurance policy, upon the failure of Section 311(f) to extend the definition of a tranferee to include a "beneficiary," as was done by Section 900 (e) of the estate tax when it added to the definition of those who are included in the term "transferee" "a person who, under section 827 (b), is personally liable for any part of the tax." The legislative history of Sections 311 and 900 shows that no such implication can properly be drawn from it.

Sections 311 and 900 were originally enacted as Sections 280 and 316, respectively, of the Revenue Act of 1926, c. 27, 44 Stat. 9. They were intended to be correlative provisions. H. Conference Rep. No. 356, 69th Cong., 1st Sess., pp. 42–45, 50 (1939-1 Cum. Bull. (Part 2) 361, 371–373, 376). The report contained an extensive discussion of Section 280 of the Act at pages 42 through 45. At page 50, there is a brief discussion of Section 316 (Appendix, *infra*, p. 46),

but a more extensive discussion of the section was omitted because, as the report said at page 50, its general effect was explained by the discussion of Section 280. Until 1942, Sections 311 (f) and 900 (e) were identical. At that time Section 900 (e) was amended by Section 411 of the Revenue Act of 1942, c. 619, 56 Stat. 798, which added the phrase "and includes a person who, under section 827 (b), is personally liable for any part of the tax." The legislative history of that amendment shows that it was not intended to change the theory of transferee liability as regards the estate tax in comparison to the income tax, but rather was merely intended to make specific one of the many classes of transferees normally considered to have been implicitly included within the purview of Section 900 from its inception. Thus H. Rep. No. 2333, 77th Cong., 2d Sess., p. 168 (1942-2 Cum. Bull. 372, 495), states briefly that—

> This section also makes more specific the definition of "transferee" in section 900 (e) of the Internal Revenue Code, which, however, is not all-inclusive.

In *Hays* v. *Commissioner,* 34 B. T. A. 808, 815, the Board of Tax Appeals gave effect to the transferee provision of the estate tax by holding that the beneficiaries of life insurance policies, in which the decedent retained until his death the right to change the beneficiaries, were "distributees of property of the decedent," and therefore liable as transferees for unpaid estate taxes. This legislative history and case law justify an analogy between the transferee provisions of the income tax and estate tax to show that for both

purposes a beneficiary was intended to be classed as a transferee as to the proceeds of an insurance policy. And far from being in no sense the property of the decedent, the proceeds of the insurance policies may be classed as part of his gross estate because of his retention of incidents of ownership, in this case the right to change the beneficiary.

The Government's position is supported also by the fact that the beneficiary of a policy of insurance in which the right to change the beneficiary is reserved by the insured, as here, has no vested right therein, but only an expectancy or mere inchoate right. *Royal Arcanum* v. *Behrend,* 247 U. S. 394; *Mutual Ben. Life Ins. Co.* v. *Swett,* 222 Fed. 200 (C. A. 6); *Morgan* v. *Penn. Mut. Life Ins. Co.,* 94 F. 2d 129 (C. A. 8); *Metropolitan Life Ins. Co.* v. *Tye,* 288 Ky. 750; *Hoskins* v. *Hoskins,* 231 Ky. 5, 10. In the *Swett* case, *supra,* the court, after stating that the rule is well settled that, under an ordinary policy of life insurance in which there is no reservation of a right to change the beneficiary, the beneficiary acquires at the moment the policy is issued a vested right which would not be affected by any act of the insured, said (pp. 204–205):

> If, however, by the terms of the policy itself there is reserved to the insured the right, without the consent of the beneficiary, to change the appointee with the assent of the insurer, the beneficiary acquires only an expectancy and not a vested interest during the life of the insured. * * *
>
> * * * Her [the beneficiary's] right was inchoate, a mere expectancy during his lifetime, de-

> pendent on the will and pleasure of her husband as holder of the policy, and could not vest until his death happened with the policy unchanged. *His control over the policy was, subject to its items, as complete as if he himself had been the beneficiary.* [Italics supplied.]

Thus the transfer of the proceeds of an insurance policy in which the insured retains the right to change the beneficiary occurs upon the death of the insured.

Life insurance contracts are not insurance from year to year but rather "entire contracts for life," subject to forfeiture, of course, for failure to perform the conditions required. *McMaster* v. *New York Life Ins. Co.*, 183 U. S. 25, 35[3]; *Burnet* v. *Wells*, 289 U. S. 670, 679. The premium payments constitute the consideration for the entire assurance for life. *New York Life Ins. Co.* v. *Statham*, 93 U. S. 24. From the moment the insured pays the first premium he acquires an asset which he has the power to do with as he pleases during life and dispose of as he chooses at death. His obligation to pay the premiums is the consideration for the promise of the company to pay the face amount of the policy, less any outstanding loan, at death. His interest in the policy and his right to dispose of it at death are not unlike his power to dispose of other property by will. That which passes to the beneficiary is what the insured purchased by performing his policy obligations and by failing to exercise his policy privileges. The fact that that which the beneficiary receives may be something different from that which the insured

[3] For the minority view that life insurance runs from year to year, with a right of renewal, see *Worthington* v. *Charter Oak Life Insurance Co.*, 41 Conn. 372.

himself normally would receive during his lifetime, namely, the policy proceeds, does not vitiate the fact that by his control over the policy the insured can effect a transfer of the entire proceeds either to a particular beneficiary or to his estate. See *Chase Nat. Bank* v. *United States, supra.*

Certainly a life insurance policy payable to the executors, administrators, or assigns of the insured is his property, subject to the claims of his creditors. *Bank of Minden* v. *Clement,* 256 U. S. 126. When the estate is the beneficiary, the proceeds are subject to payment of the decedent's delinquent income taxes even after having been distributed by the estate. *Kieferdorf* v. *Commissioner,* 142 F. 2d 723 (C. A. 9), certiorari denied, 323 U. S. 733. In *Cohen* v. *Samuels,* 245 U. S. 50, this Court denied significance to the distinction between such a policy and one which, although payable to a named beneficiary, may be made payable to the insured's estate and thus subject to satisfy the claims of his creditors. The Court held that where a bankrupt had reserved the right to change the beneficiary of his insurance policies, which had a cash surrender value at the time of adjudication, those policies became an asset in the trustee even though they were payable to someone other than the bankrupt, his estate, or personal representatives. Referring to the fact that the policies were not payable to the bankrupt or his estate, the Court said (p. 53):

> It is true the policies in question here are not so payable, but they can be or could have been so payable at his own will and by simple decla-

ration. Under such conditions to hold that there was nothing of property to vest in a trustee would be to make an insurance policy a shelter for valuable assets and, it might be, a refuge for fraud.

The same reasoning supports the conclusion here that the proceeds of decedent's insurance policies were "property of a taxpayer" within the meaning of that term as used in Section 311 of the Code by reason of decedent's right to change the beneficiary, an incident of ownership; and that upon decedent's death, they were transferred to the beneficiary without consideration, leaving decedent's estate insolvent. The respondent, therefore, was a transferee of the proceeds, and the Government was entitled to pursue them into her hands to be applied to the payment of decedent's unpaid income taxes.

II

ALTERNATIVELY, REGARDLESS OF WHETHER THERE IS A TRANSFER OF THE ENTIRE PROCEEDS, THE BENEFICIARY IS A TRANSFEREE OF THE CASH SURRENDER VALUE WHICH THE INSURED RETAINED THE RIGHT TO WITHDRAW DURING HIS LIFETIME

Apart from whether the respondent was a transferee as to the entire proceeds of the decedent's life insurance, we submit that the court below erred in holding that the cash surrender values were not assets of the decedent during his lifetime and that the respondent did not become a transferee of the surrender values upon his death. In *New York Life Insurance Co.* v. *Statham*, 93 U. S. 24, this Court discussed the equitable value or cash surrender value of a lapsed policy, explaining that it derived from an excess of

premiums paid over the annual cost of the insurance, and stated (p. 34) that "It belongs, in one sense, to the insured who has paid them, somewhat as a deposit in a savings bank is said to belong to the person who made the deposit."[3a] Due to the impossibility of paying premiums during the Civil War, the policy had lapsed, and the insurance company subsequently refused, under the terms of the policy, to pay anything at all. This Court held that the company would not be liable to the full extent of the face amount, but would be held to return the equitable value, saying (p. 35):

> To forfeit this excess [of premiums paid], which fairly belongs to the assured, and is fairly due from the company, and which the latter actually has in its coffers, and to do this for a cause beyond individual control, would be rank injustice. It would be taking away from the assured that which had already become substantially his property.

The Court expressed the same idea in *Hiscock* v. *Mertens*, 205 U. S. 202, 211–212, and *Burlingham* v. *Crouse*, 228 U. S. 459, 469, quoting and approving the following language of Judge Addison Brown in *In re McKinney*, 15 Fed. 535, 537 (S. D. N. Y.):

> The first of these elements, the surrender value of the policy, arises from the fact that the fixed annual premium is much in excess of the annual risk during the earlier years of the pol-

[3a] In *Grigsby* v. *Russell*, 222 U. S. 149, 156, the Court said, "On the other hand, life insurance has become in our days one of the best recognized forms of investment and self-compelled saving. So far as reasonable safety permits, it is desirable to give to life policies the ordinary characteristics of property."

icy, an excess made necessary in order to balance the deficiency of the same premium to meet the annual risk during the latter years of the policy. This excess in the premium paid over the annual cost of insurance, with accumulations of interest, constitutes the surrender value. Though this excess of premiums paid is legally the sole property of the company, still in practical effect, though not in law, it is moneys of the assured deposited with the company in advance to make up the deficiency in later premiums to cover the annual cost of insurance, instead of being retained by the assured and paid by him to the company in the shape of greatly-increased premiums, when the risk is greatest. It is the "net reserve" required by law to be kept by the company for the benefit of the assured, and to be maintained to the credit of the policy. So long as the policy remains in force the company has not practically any beneficial interest in it, except as its custodian, with the obligation to maintain it unimpaired and suitably invested for the benefit of the insured. This is the practical, though not the legal, relation of the company to this fund.

Thus, the flat holding of the court below that the cash surrender values were not the property of the insured while he lived is contrary to the practical view of surrender values taken by this Court. Yet this Court and others have often stated that taxation is an eminently practical matter. *Tyler* v. *United States*, 281 U. S. 497, 503; *Barrett* v. *Commissioner*, 185 F. 2d 150, 151 (C. A. 1); *Kohn* v. *Commissioner*, 197 F. 2d 480, 482 (C. A. 2); *Seward's Estate* v. *Commissioner*, 164 F. 2d 434 436 (C. A. 4); *Ozark Chemical Co.* v.

Jones, 125 F. 2d 1, 2 (C. A. 10), certiorari denied, 316 U. S. 695.

In *Rowen* v. *Commissioner,* 215 F. 2d 641, 647, the Court of Appeals for the Second Circuit also held, contrary to the view of the court below, that the surrender values were the property of the insured, saying:

> It is indisputable that the policies as to their cash surrender values were assets of the decedent in his lifetime. Since under the terms of the policies nothing passed on his death, it is not realistic to view his death as wiping out these values. Under the policies, his death was merely a condition upon which the surrender values no longer were payable to the decedent but became merged in the greater values which the insurers were obligated to pay the beneficiaries. Thus even though, as we held earlier in this opinion, the *entire* proceeds were never an asset belonging to the decedent, the proceeds to the extent of the cash surrender values which were included therein were property once belonging to the decedent in his lifetime and as to those values the beneficiaries were transferees.

The court in that case went on to hold that although the beneficiaries were transferees of the surrender values they were not liable as such by reason of a state statute. (The next section of this brief is directed toward the latter issue.)

The Court of Appeals for the Second Circuit reexamined the *Rowen* case with respect to the surrender values in *United States* v. *Behrens,* 230 F. 2d 504, certiorari denied, 351 U. S. 919, again holding that such values are in practical effect the property of the insured and are not wiped out upon his death

but merge in the proceeds. In that case the Government contended that a tax lien had attached to the surrender values while the insured lived, and that it remained attached thereto after his death when the surrender values merged in the proceeds. The Court of Appeals agreed.

Essentially the view of the court below conflicts also with its own position in an earlier case, *Knox* v. *Great West Life Assur. Co.*, 212 F. 2d 784 (C. A. 6), where a tax lien on all the property of the insured was held to be enforceable against the cash surrender values of his life insurance. Numerous other cases have held the same. *United States v. Metropolitan Life Ins. Co.*, decided January 14, 1958 (C. A. 4); *Kyle* v. *McGuirk*, 82 F. 2d 212 (C. A. 3); *Smith* v. *Donnelly*, 65 F. Supp. 415 (E. D. La.); *United States* v. *Prudential Ins. Co. of America*, 54 F. Supp. 664 (E. D. Pa.); *United States* v. *Ison*, 67 F. Supp. 40 (S. D. N. Y.); *United States* v. *Royce Shoe Co.*, 137 F. Supp. 786 (D. N. H.); cf.; *United States* v. *Trout*, 46 F. Supp. 484 (S. D. Cal.). Such liens could never have attached to the surrender values in the first place if those values were not property or rights to property belonging to the insured. Section 3670, Internal Revenue Code of 1939 (Appendix, *infra*, pp. 45–46).

The court below stands alone also in its view that the beneficiary is not a transferee of the surrender values. As the Court of Appeals said in *Rowen*, to regard the death of the insured as wiping out those values would indeed be unrealistic. An insurance company actually lays aside and invests a reserve fund equal to the surrender value, to be appropriated to the payment of the policy when it falls due. *New York*

Life Ins. Co. v. *Statham,* 93 U. S. 24, 34. See Vance, *Insurance* (3d ed. 1951), pp. 607–624. Thus, following the insured's death, the surrender value indeed continues to exist and constitutes an actual part of the whole proceeds. In *John Hancock Mut. Life Ins. Co.* v. *Helvering,* 128 F. 2d 745, 747, the Court of Appeals for the District of Columbia stated that—

> as long as the insured pays his premiums * * * part of the money usually builds up an "equity" that may be accumulated, cashed, or diverted into paid up protection, and when the insured dies this "equity" may in a sense be transferred to his beneficiaries who have an important "claim" against the company.

In *United States* v. *Bess,* 243 F. 2d 675, certiorari granted, October 28, 1957, the Court of Appeals for the Third Circuit followed its earlier decision in *Pearlman* v. *Commissioner,* 153 F. 2d 560, and explained its holding to mean that the beneficiary of life insurance policies may be liable as a transferee of the surrender values. In *United States* v. *Hoper,* 242 F. 2d 468, the Court of Appeals for the Seventh Circuit followed *United States* v. *Behrens, supra,* holding that a tax lien attached to the cash surrender values prior to the death of the insured remains enforceable to the extent of the cash surrender values against the proceeds in the beneficiary's hands. The upshot of all these decisions, whether or not involving a lien, is that cash surrender values available to the insured before his death do not just evaporate thereafter, but are indeed transferred to the beneficiary, merged in the proceeds. And if such transfer leaves the estate of the decedent insolvent and unable to pay his de-

linquent income taxes, then the effect is that the beneficiary is a transferee.

That this asset of the decedent which would have been available to satisfy his tax liability had he lived should remain available after his death is entirely equitable and appropriate. A portion of the income taxes which the Government seeks to recover in this proceeding is owing by reason of decedent's fraud in concealing income. That was specifically found by the Tax Court in the previously litigated case (*Stern* v. *Commissioner,* decided February 15, 1955 (1955 P–H T. C. Memorandum Decisions, par. 55,040)), as follows:

> The record does not disclose isolated instances of insignificant omissions or occasional discrepancies, but rather a wholesale scheme of fabrication, misstatement, misrepresentation, perversion, and falsification to cheat the Government out of its lawfully due revenue. That Dr. Stern committed acts with the purpose of evading taxes for each of the years here involved has been proven by clear and convincing evidence.

Dr. Stern was carrying the life insurance policies concerned here all the while he was defrauding the Government of taxes due it (R. 12–13). If he had honestly reported his income, he could have paid the taxes due at a time when he was not insolvent. Or if he had honestly reported his income but failed to pay the taxes due, the Government could have reached the cash surrender values of his insurance while he lived. *United States* v. *Metropolitan Life Ins. Co.,* decided January 14, 1958 (C. A. 4); *Knox* v. *Great West Life Assur. Co.,* 109 F. Supp. 207 (E. D.

Mich.), affirmed, 212 F. 2d 784 (C. A. 6); *Cannon* v. *Nicholas*, 80 F. 2d 934 (C. A. 10). In *United States* v. *Hoper*, 242 F. 2d 468, 470 (C. A. 7), also a case involving the Government's right to follow the surrender values of life insurance into the hands of beneficiaries, the Court of Appeals said:

> Assuming equitable considerations have some place in this proceeding, surely the sudden death of the taxpayer cannot be held against the government and inure to the benefit of defendants. Nor is there anything inequitable or arbitrary about the government's pursuing the defendants to collect the taxpayer's delinquent taxes.

To deprive the Government of the right to reach the surrender values in this proceeding would be to do what this Court has said it would not do—that is, to justify a greater tax advantage to a taxpayer who underpays his correct tax over one who pays in full when due. *United States* v. *Koppers Co.*, 348 U. S. 254, 263; *United States* v. *Gilmore*, 222 F. 2d 167, 169 (C. A. 5), certiorari denied, 350 U. S. 843.

III

SINCE THE PRESENT PROCEEDING IS ONE TO ENFORCE COLLECTION OF A FEDERAL TAX, THE LIABILITY OF THE TRANSFEREE CANNOT BE LIMITED BY STATE LAW

The holding of the Court of Appeals, upon the authority of *Rowen* v. *Commissioner*, 215 F. 2d 614 (C. A. 2), that the liability of a transferee should be limited by state law is, we submit, erroneous. Its origin lies in an earlier decision of the Second Circuit, *Hatch* v. *Morosco Holding Co.*, 50 F. 2d 138, certiorari denied *sub nom. Irving Trust Co.* v. *United States*,

284 U. S. 668,[4] which was followed in *Harwood* v. *Eaton,* 68 F. 2d 12 (C. A. 2), certiorari denied, 292 U. S. 636, which in turn was overruled in *Commissioner* v. *Western Union Tel. Co.,* 141 F. 2d 774 (C. A. 2), certiorari denied, 322 U. S. 751. Meanwhile the Court of Appeals for the Fifth Circuit had also followed the *Morosco Holding Co.* case in *Liquidators of Exchange Nat. Bank* v. *United States,* 65 F. 2d 316. Subsequently the Court of Appeals for the Eighth Circuit reached the same conclusion in *Botz* v. *Helvering,* 134 F. 2d 538, relying on three decisions of this Court, *Freuler* v. *Helvering,* 291 U. S. 35; *Blair* v. *Commissioner,* 300 U. S. 5; and

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[4] *Hatch* v. *Morosco Holding Co., supra,* cited three cases in support of this proposition: *United States* v. *Updike,* 281 U. S. 489, 493; *Phillips* v. *Commissioner,* 42 F. 2d 177 (C. A. 2), which was at that time pending on certiorari in this Court; and *Wire Wheel Corp.* v. *Commissioner,* 16 B. T. A. 737, affirmed *per curiam,* 46 F. 2d 1013 (C. A. 2). We find nothing in the *Updike* case which would appear to support the proposition. *Phillips* merely relied on a New York state court decision to support the holding that a transferee of a corporation could be held liable for more than his proportionate share of the corporation's debts. It did not say that transferee liability for taxes was imposed by local law, and when this Court subsequently affirmed (283 U. S. 589), it specifically reserved decision on that point. The basis of the *Wire Wheel Corp.* case, affirmed without opinion by the Court of Appeals, is at best ambiguous, but at most it appears to hold that the Commissioner had failed to exhaust his remedies against the transferor under either state or federal law. Thus these cases are highly doubtful authority for the statement in *Hatch* v. *Morosco Holding Co., supra,* p. 139, that Section 280 of the Revenue Act of 1926 permitted collection from a transferee of taxes owed by the transferor "to the extent that the municipal law makes him liable at law or in equity for the transferor's taxes."

Helvering v. *Stuart*, 317 U. S. 154. More recently, in *United States* v. *Truax*, 223 F. 2d 229 (C. A. 5), a case involving the transferee liability of the beneficiary of life insurance, the Court of Appeals for the Fifth Circuit followed *Rowen* and its own earlier decision in *Liquidators of Exchange Nat. Bank* v. *Commissioner, supra*, in holding that the liability of the transferee must be found in state law. The decisions above, all except *Botz* v. *Helvering, supra*, having their ultimate roots in *Hatch* v. *Morosco Holding Co., supra*, we submit are erroneous. The three decisions of this Court upon which *Botz* v. *Helvering* purports to rely are not transferee cases and, we submit, in agreement with *Pearlman* v. *Commissioner*, 153 F. 2d 560 (C. A. 3), are not in point.[5]

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[5] *Freuler* v. *Helvering*, 291 U. S. 35, concerned the measurement of income from trust property for tax purposes, and this Court held that a decree of a state court having jurisdiction of the trust, determining that annual deductions for depreciation of the trust property should have been taken from gross income before making distributions to life income beneficiaries, and requiring them to make restitution accordingly, established the rights of the parties and was an "order governing the distribution" of income within the meaning of Section 219 (d) of the Revenue Act of 1921, c. 136, 42 Stat. 227.

Blair v. *Commissioner*, 300 U. S. 5, held that the validity of certain assignments of trust income was a question of local law and that a prior decision by the Seventh Circuit, holding that the trust was a spendthrift trust under local law, was not *res judicata* insofar as the local law was determinative of any material point in controversy, because of a supervening decision of the state court. But the liability of the assignor for the tax, if the assignments were valid, was held to be a federal question.

Helvering v. *Stuart*, 317 U. S. 154, held that the grantor of a trust was taxable upon the income thereof under Sections 166 and 167 of the Revenue Act of 1934, c. 277, 48 Stat. 680,

In the case of *Phillips* v. *Commissioner,* 283 U. S. 589, this Court reserved decision of the question whether the liability of a transferee is limited by state law. However, other decisions have pointed to the result for which we contend, and the rationale of Section 311 of the Internal Revenue Code of 1939 (originally Section 280 of the Revenue Act of 1926, *supra*) as explained in its legislative history requires it. In the first place essentially the Government here is seeking to collect a federal income tax. This Court has held that such a proceeding against a transferee "is in every real sense a proceeding in court to collect a tax." *United States* v. *Updike,* 281 U. S. 489, 494. The tax imposed upon the transferor, said the Court, is the basis of the liability, whether sought to be enforced directly against the transferor or by suit against the transferee. The aim in either case is to enforce a tax liability, and "it puts no undue strain upon the word 'taxpayer' to bring within its meaning that person whose property, being impressed with a trust to that end, is subjected to the burden." *United States* v. *Updike, supra,* p. 494. Thus the transferee is a taxpayer and the liability sought to be enforced against him is in reality a tax liability. This being true, state law ought not to be invoked to limit it; for ultimately it is a liability which has been fixed by Congress. The Court of Appeals for the Seventh Circuit in *First Nat. Bank* v. *Commissioner,* 112 F.

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insofar as the trust instrument, construed under state law, allowed any person not having a substantial adverse interest to revest the corpus of the trust in the grantor or to distribute to the grantor any part of the trust income.

2d 260, 262, certiorari denied, 311 U. S. 691, stated this as follows:

> Congress has seen fit, in order to prevent evasion of taxes, to fix a tax liability not only upon the transferor of property but, in case of his inability or failure to pay, likewise upon assets transferred by him.

Earlier the same court said in a transferee case, *Commissioner* v. *Keller,* 59 F. 2d 499, 501, that, although state laws control with respect to questions of property, "as to a question of the kind now under consideration the decisions of the federal courts must prevail."[6] In *United States* v. *Motsinger,* 123 F. 2d 585, 589, a fiduciary was the transferee, and the Court of Appeals for the Fourth Circuit said that it would be the harshest sort of technicality—

> To treat the liability of the fiduciary as an entirely new and independent liability and to close one's eyes to the patent fact that it is, in reality, the old tax liability of the original taxpayer which is being enforced * * *.

The necessity for uniformity in the field of transferee liability for taxes has been recognized by the Court of Appeals for the Third Circuit. In *Pearlman* v. *Commissioner,* 153 F. 2d 560, the court held that the liability of recipients of transferred assets for unpaid taxes of decedents was a federal tax question to be decided on the basis of general law as declared by federal courts, saying (p. 562):

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[6] Although the Seventh Circuit stated that it was following the *Rowen* case in *United States* v. *New,* 217 F. 2d 166, it did so without discussion of this point, which was not necessary to the decision.

On principle the question seems to us clearly one to be answered without reference to state law limitations. It would not be disputed that, in general, the imposition and collection of federal income tax is a federal function. One of the questions arising from such an undertaking is the determination of when B is to be liable to pay a tax assessed against A. The Congress could, no doubt, have left this question to be variously determined by the laws of the respective states if it had so desired. But in the absence of a clearly expressed intention to do so, we should not infer it, for such variation does not fit into a uniformly applied system of federal taxation.

The court reaffirmed this position in *United States* v. *Bess*, 243 F. 2d 675, 677, certiorari granted, October 28, 1957, adhering to its former ruling "that since there was a federal tax question to be decided it should be decided on general law as laid down by the Federal courts and not be subject to the limitation in the law of any State." Indeed, the court noted that, had state law applied, the cash surrender values would not have been reachable in the beneficiary's hands.

The position taken by the Court of Appeals for the Second Circuit in *Rowen* v. *Commissioner, supra,* that the liability of a transferee must be based on state law because the court knew of no general law as declared by federal courts defining the liability of a transferee is grounded in the idea that the liability of a transferee is a separate question from his status as a transferee. In that court's opinion, one may be a transferee without being liable as such, and *Rowen* indeed held that the beneficiary was a transferee of

the cash surrender values but not liable by reason of state law. This fragmentation of what is essentially a single question of federal law results, we submit, from a highly technical and unwarranted interpretation of Section 311 of the Code. If the question involves two elements, both ought to be decided by federal law.

Section 311 did not establish any new transferee liability, but merely authorized the Commissioner to utilize against transferees the same summary collection procedures available against other taxpayers. *Phillips* v. *Commissioner,* 283 U. S. 589. Prior to the Revenue Act of 1926 the United States in an equity proceeding could recover taxes from transferees without assessment against them, and *Leighton* v. *United States,* 289 U. S. 506, held that such an equity proceeding remained available to the Government even after the creation of the summary remedy. But in none of the cases in which the Government utilized the equity procedure prior to the Revenue Act of 1926 did any court suggest that the liability of a transferee was a separate question from his status as a transferee or that state law was involved. On the contrary, it was universally assumed that one who received property without giving adequate consideration therefor from another who was thereby left insolvent (or in the case of a corporation defunct) and unable to pay his outstanding tax debts was a transferee and liable for payment of the taxes to the extent of the transferred property. See cases collected in *Phillips* v. *Commissioner,* 283 U. S. 589, 592–593, fn. 2; 9 Mertens, *Law of Federal Income Taxation,* Section 53.26. This was

an application of the general equitable principle, known as the trust fund doctrine, applied in the federal courts. *Erie R. Co.* v. *Tompkins*, 304 U. S. 64, which merely held that state law had to be applied in diversity cases in federal courts, did not repeal such general principles; they are especially appropriate in tax cases like the one at bar which are essentially federal questions requiring uniformity of liability. See *Burnet* v. *Harmel*, 287 U. S. 103; *United States* v. *Gilbert Associates*, 345 U. S. 361. Cf. *Clearfield Trust Co.* v. *United States*, 318 U. S. 363, 367; *Hinderlider* v. *La Plata Co.*, 304 U. S. 92, 110;[7] *Will* v. *Commissioner*, 62 F. 2d 777, 779 (C. A. 2); *Girard Trust Co.* v. *United States*, 149 F. 2d 872, 874 (C. A. 3); *O'Brien* v. *Western Union Telegraph Co.*, 113 F. 2d 539, 541 (C. A. 1); *Mills* v. *Sarjem Corp.*, 133 F. Supp. 753 (D. N. J.). This Court, moreover, has held in *Phillips-Jones Corp.* v. *Parmley*, 302 U. S. 233, 236, that the right of a transferee who has paid the tax to contribution from other transferees "arises under the general law." Since, therefore, federal law established transferee liability prior to the Revenue Act of 1926, and since, further, Section 280 of that Act was merely designed as an additional procedural method for the enforcement of

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[7] The *Hinderlider* opinion, handed down the same day as *Erie R. Co.* v. *Tompkins*, *supra*, and written by the same justice, stated (p. 110) that in determining controversies over rights in interstate streams, the federal courts administer a "'federal common law' upon which neither the statutes nor the decisions of either State can be conclusive."

transferee liability, the Court of Appeals for the Second Circuit was in error in the *Morosco Holding Co.* and *Rowen* cases in relying upon the language of the section to divide a theretofore single issue of federal law into two separate questions, one of which was to be governed by state law.

Congress, we submit, manifested no intention that Section 280 should be interpreted by the courts to limit transferee liability by state law. Such limitations can only result in decisions which, far from being uniform throughout the country, would vary from state to state. But the legislative history of Section 280 shows that Congress intended to promote uniformity. That section was introduced as Senate Amendments Nos. 87 and 88 to the Revenue Act of 1926, and was explained and discussed in H. Conference Rep. No. 356, 69th Cong., 1st Sess., pp. 42–45 (1939-1 Cum. Bull. (Part 2), 361, 371–373). This report stated (p. 43) that it was not meant, through the introduction of Section 280, to change transferee liability under "existing law." As we have shown above, the existing law referred to must have been the general body of federal equitable principles, including the trust fund doctrine.

In addition, the report stated (p. 44):

> The amendment thereby substitutes the specialized and more expeditious procedure of the Board for that of the district courts in equity and will develop through the Board a uniformity of precedents in lieu of the present rather vague principles of law governing the liability

of a transferee for unpaid taxes of a transferor.[8]

The Tax Court, we submit, has consistently attempted in numerous cases to carry out the congressional purpose by imposing transferee liability without regard to the limitations of state law. *Muller* v. *Commissioner*, 10 T. C. 678; *Neely* v. *Commissioner*, decided August 10, 1949 (1949 P-H T. C. Memorandum Decisions, par. 49,188); *Sullivan* v. *Commissioner*, decided January 11, 1950 (1950 P-H T. C. Memorandum Decisions, par. 50,000); *Leary* v. *Commissioner*, 18 T. C. 139; *Rowen* v. *Commissioner*, 18 T. C. 874; reversed, 215 F. 2d 641 (C. A. 2); *Tyson* v. *Commissioner*, decided June 5, 1953 (1953 P-H T. C. Memorandum Decisions, par. 53,198), reversed *per curiam*, 212 F. 2d 16 (C. A. 6); *Bales* v. *Commissioner*, 22 T. C. 355; *Wendell* v. *Commissioner*, decided February 23, 1956 (1956 P-H T. C. Memorandum Decisions,

[8] The following language of the H. Conference Rep. should also be noted (p. 43):

> By reason of the trust fund doctrine and various State statutory provisions the transferee of assets of an insolvent transferor is ordinarily liable for the accrued and unpaid taxes of the transferor.

The reference "the trust fund doctrine and various State statutory provisions" affirmatively shows that Congress recognized the existence of a trust fund doctrine without regard to state law. The reference to state law merely indicates the desire to take advantage of any additional liability provided for by state statute. Judge Learned Hand, concurring in *Harwood* v. *Eaton*, 68 F. 2d 12, 15 (C. A. 2), certiorari denied, 292 U. S. 636, expressed this thought when he said, "I have some doubt whether this [liability of a transferee] includes only liabilities existing by virtue of the state law, as my brothers believe * * *."

par. 56,040); *Stoumen* v. *Commissioner*, 27 T. C. 1014, pending on appeal (C. A. 3).

At all events, Sections 297.140 and 297.150 of the Kentucky Revised Statutes (Appendix, *infra*, pp. 46–47), held by the Court of Appeals in the instant case to limit the liability of the beneficiary as transferee, are exemption provisions, and for that reason alone not applicable in this proceeding. Just as in the situation where a tax lien has attached it is held that state law may not destroy that lien, so here, where a tax liability is imposed by Congress, the state may not provide exemptions.

The Court of Appeal admits that state laws exempting insurance are inoperative as against federal tax liens, and in fact has itself so held in a case involving a Michigan exemption statute identical in part to the Kentucky statute here. *Knox* v. *Great West Life Assur. Co.*, 212 F. 2d 784 (C. A. 6). The theory upon which the state exemption provisions give way in the face of a federal tax lien is that the federal lien is supreme, whether the exemptions involve homesteads (*Shambaugh* v. *Scofield*, 132 F. 2d 345 (C. A. 5); *United States* v. *Heffron*, 158 F. 2d 657 (C. A. 9), certiorari denied, 331 U. S. 831), spendthrift trusts (*United States* v. *Dallas Nat. Bank*, 152 F. 2d 582 (C. A. 5); *Matter of Rosenberg*, 269 N. Y. 247, certiorari denied *sub nom. Rosenberg* v. *United States*, 298 U. S. 669), or insurance (*Knox* v. *Great West Life Assur. Co., supra; Kyle* v. *McGuirk*, 82 F. 2d 212 (C. A. 3)). For the same reason that state exemptions are ineffective as against federal tax liens, they should be ineffective as against the general authority of the fed-

eral government to collect taxes which is contained in the same federal statute. Statements by this Court and others clearly imply that no particular significance attaches to a lien, but rather, generally, that state exemption provisions are inapplicable wherever they conflict with a federal claim for taxes. This Court itself has said "that the laws of the State creating these exemptions are not laws for the United States * * * unless they have been made such by Congress itself." *Fink* v. *O'Neil,* 106 U. S. 272, 276. And certainly they have not been made such by the Internal Revenue Code. However, they were made applicable in bankruptcy by the Federal Bankruptcy Act, and for that very reason the Court of Appeals' reliance, with respect to this issue, on such bankruptcy cases as *Lockwood* v. *Exchange Bank,* 190 U. S. 294; *Holden* v. *Stratton,* 198 U. S. 202; *Hiscock* v. *Mertens,* 205 U. S. 202; and *In re Pfaffinger,* 164 Fed. 526 (W. D. Ky), is altogether misplaced. In *Cannon* v. *Nicholas,* 80 F. 2d 934 (C. A. 10), the Court of Appeals said (p. 935) that "Congress has not in the revenue laws, as it did in bankruptcy, recognized state exemption statutes; nor has it exempted either annuity contracts or life insurance policies." The court held the Colorado statute there involved to be an exemption provision, saying (p. 938) that "As such, it is not applicable to federal taxes." See also *Kyle* v. *McGuirk, supra.* And in *Kieferdorf* v. *Commissioner,* 142 F 2d 723 (C. A. 9), certiorari denied, 323 U. S. 733, although there was no lien on the proceeds of the insurance at the time it was distributed from the decedent's estate, which was the

named beneficiary, to his widow and children, yet the latter were held liable as transferees for the decedent's unpaid income taxes, the court saying (p. 725) that "the California law cannot create exemptions from execution or attachment for the collection of Federal taxes." *Murphy* v. *Casey*, 150 Minn. 107, from which the court below quoted profusely, is inapplicable here because the state exemption statute there was invoked merely as between an insured and his private creditor. No federal tax claim was involved.

We submit that the Kentucky statutes are, accordingly, irrelevant with respect to the present action, and that the transferee liability of Mrs. Stern for her husband's delinquent income taxes is a federal question to be decided on the basis of the general principles established by federal courts.

CONCLUSION

For the reasons stated, the judgment of the Court of Appeals should be reversed.

Respectfully submitted,

J. Lee Rankin,
Solicitor General.
Charles K. Rice,
Assistant Attorney General.
John F. Davis,
Assistant to the Solicitor General.
A. F. Prescott,
Kenneth E. Levin,
Attorneys.

February, 1958.

APPENDIX.

Internal Revenue Code of 1939:

SEC. 311. TRANSFERRED ASSETS.

(a) *Method of Collection.*—The amounts of the following liabilities shall, except as hereinafter in this section provided, be assessed, collected, and paid in the same manner and subject to the same provisions and limitations as in the case of a deficiency in a tax imposed by this chapter (including the provisions in case of delinquency in payment after notice and demand, the provisions authorizing distraint and proceedings in court for collection, and the provisions prohibiting claims and suits for refunds):

(1) *Transferees.*—The liability, at law or in equity, of a transferee of property of a taxpayer, in respect of the tax (including interest, additional amounts, and additions to the tax provided by law) imposed upon the taxpayer by this chapter.

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Any such liability may be either as to the amount of tax shown on the return or as to any deficiency in tax.

*　　*　　*　　*　　*

(f) *Definition of "Transferee".*—As used in this section, the term "transferee" includes heir, legatee, devisee, and distributee.

(26 U. S. C. 311.)

SEC. 811. GROSS ESTATE.

The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or

personal, tangible or intangible, wherever situated, except real property situated outside of the United States—

* * * * *

(g) [As amended by Sec. 404 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Proceeds of Life Insurance.*—

(1) *Receivable by the executor.*—To the extent of the amount receivable by the executor as insurance under policies upon the life of the decedent.

(2) *Receivable by other beneficiaries.*—To the extent of the amount receivable by all other beneficiaries as insurance under policies upon the life of the decedent (A) purchased with premiums, or other consideration, paid directly or indirectly by the decedent, in proportion that the amount so paid by the decedent bears to the total premiums paid for the insurance, or (B) with respect to which the decedent possessed at his death any of the incidents of ownership, exercisable either alone or in conjunction with any other person. For the purposes of clause (A) of this paragraph, if the decedent transferred, by assignment or otherwise, a policy of insurance, the amount paid directly or indirectly by the decedent shall be reduced by an amount which bears the same ratio to the amount paid directly or indirectly by the decedent as the consideration in money or money's worth received by the decedent for the transfer bears to the value of the policy at the time of the transfer. For the purposes of clause (B) of this paragraph, the term "incident of ownership" does not include a reversionary interest.

(3) *Transfer not a gift.*—The amount receivable under a policy of insurance

transferred, by assignment or otherwise, by the decedent shall not be includible under paragraph (2) (A) if the transfer did not constitute a gift, in whole or in part, under Chapter 4, or, in case the transfer was made at a time when Chapter 4 was not in effect, would not have constituted a gift, in whole or in part, under such chapter had it been in effect at such time.

* * * * *

(26 U. S. C. 811.)

SEC. 827. LIEN FOR TAX.

* * * * *

(b) [As amended by Sec. 411 (a) of the Revenue Act of 1942, *supra*] *Liability of Transferee, Etc.*—If the tax herein imposed is not paid when due, then the spouse, transferee, trustee, surviving tenant, person in possession of the property by reason of the exercise, nonexercise, or release of a power of appointment, or beneficiary, who receives, or has on the date of the decedent's death, property included in the gross estate under section 811 (b), (c), (d), (e), (f), or (g), to the extent of the value, at the time of the decedent's death, of such property, shall be personally liable for such tax. Any part of such property sold by such spouse, transferee, trustee, surviving tenant, person in possession of property by reason of the exercise, nonexercise, or release of a power of appointment, or beneficiary, to a bona fide purchaser for an adequate and full consideration in money or money's worth shall be divested of the lien provided in section 827 (a) and a like lien shall then attach to all the property of such spouse, transferee, trustee, surviving tenant, person in possession, or beneficiary, except any part sold to

a bona fide purchaser for an adequate and full consideration in money or money's worth.

* * * * *

(26 U. S. C. 827.)

SEC. 900. TRANSFERRED ASSETS.

(a) *Method of Collection.*—The amounts of the following liabilities shall, except as hereinafter in this section provided, be assessed, collected, and paid in the same manner and subject to the same provisions and limitations as in the case of a deficiency in a tax imposed by this subchapter (including the provisions in case of delinquency in payment after notice and demand, the provisions authorizing distraint and proceedings in court for collection, and the provisions prohibiting claims and suits for refunds):

(1) *Transferees.*—The liability, at law or in equity, of a transferee of property of a decedent, in respect of the tax (including interest, additional amounts, and additions to the tax provided by law) imposed by this subchapter.

* * * * *

Any such liability may be either as to the amount of tax shown on the return or as to any deficiency in tax.

* * * * *

(e) [As amended by Sec. 411 (b) of the Revenue Act of 1942, *supra*.] *Definition of "Transferee".*—As used in this section, the term "transferee" includes heir, legatee, devisee, and distributee, and includes a person who, under section 827 (b), is personally liable for any part of the tax.

(26 U. S. C. 900.)

SEC. 3670. PROPERTY SUBJECT TO LIEN.

If any person liable to pay any tax neglects or refuses to pay the same after demand, the

amount (including any interest, penalty, additional amount, or addition to such tax, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

(26 U. S. C. 3670.)

Revenue Act of 1926, c. 27, 44 Stat. 9:

SEC. 316. * * *

* * * * *

(e) As used in this section, the term "transferee" includes heir, legatee, devisee, and distributee.

Kentucky Revised Statutes (1948, 4th ed.):

297.140 *Life insurance for benefit of a married woman: premiums paid in fraud of creditors.* (1) A policy of insurance on the life of any person expressed to be for the benefit of, or duly assigned, transferred or made payable to, any married woman, or to any person in trust for her, or for her benefit, by whomsoever such transfer may be made, shall inure to her separate use and benefit and that of her children, independently of her husband or his creditors or any other person effecting or transferring the policy or his creditors.

(2) A married woman may, without consent of her husband, contract, pay for, take out and hold a policy of insurance upon the life or health of her husband or children, or against loss by his or their disablement by accident. The premiums paid on the policy shall be held to have been her separate estate, and the policy shall inure to her separate use and benefit and that of her children, free from any claim of her husband or others.

(3) If the premium on any policy mentioned in this section is paid by any person with intent

to defraud his creditors, an amount equal to the premium so paid, with interest thereon, shall inure to the benefit of the creditors, subject to the statute of limitations.

297.150 *Life insurance for benefit of another; premiums paid in fraud of creditors.* (1) When a policy of insurance is effected by any person on his own life or on another life in favor of some person other than himself having an insurable interest therein, the lawful beneficiary thereof, other than the person effecting the insurance or his legal representatives, shall be entitled to its proceeds against the creditors and representatives of the person effecting the same.

(2) Subject to the statute of limitations, the amount of any premiums for such insurance paid in fraud of creditors, with interest thereon, shall inure to their benefit from the proceeds of the policy, but the company issuing the policy shall be discharged of all liability thereon by payment of its proceeds in accordance with its terms, unless, before such payment, the company received written notice by or in behalf of some creditor, with specification of the amount claimed, claiming to recover for certain premiums paid in fraud of creditors.

Treasury Regulations 105, promulgated under the Internal Revenue Code of 1939:

Sec. 81.27 [As amended by T. D. 5239, 1943 Cum. Bull. 1081, and T. D. 5699, 1949-1 Cum. Bull. 181] *Insurance Receivable by Other Beneficiaries.*—(a) *In case of decedent dying after December 31, 1947.*—The regulations prescribed under this paragraph (except as otherwise indicated in this section) are applicable only in the case of decedents who died after December 31, 1947. In such cases, the amount of the aggregate proceeds of all insurance on the life of the decedent not receivable by or for

the benefit of his estate must also be included in his gross estate, as follows:

(1) Such insurance (not includible under (2) of this paragraph) purchased with premiums, or other consideration, paid directly or indirectly by the decedent, in the proportion that the amount so paid by the decedent bears to the total premiums paid for the insurance, and

(2) Such insurance with respect to which the decedent possessed at his death any of the incidents of ownership, exercisable either alone or in conjunction with any person.

* * * * *

For the purposes of this section, the term "incidents of ownership" is not confined to ownership in the technical legal sense. For example, a power to change the beneficiary reserved to a corporation of which the decedent is sole stockholder is an incident of ownership in the decedent. For examples of "incidents of ownership" see paragraph (c) of this section. * * *

* * * * *

(c) * * *

* * * * *

Incidents of ownership in the policy include, for example, the right of the insured or his estate to its economic benefits, the power to change the beneficiary, to surrender or cancel the policy, to assign it, to revoke an assignment, to pledge it for a loan, or to obtain from the insurer a loan against the surrender value of the policy, etc. The insured possesses an incident of ownership if his death is necessary to terminate his interest in the insurance, as, for example, if the proceeds would become payable to his estate, or payable as he might direct, should the beneficiary predecease him.

* * * * *

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

Sec. 29.311-1 [As amended by T. D. 5458, 1945 Cum. Bull. 45] *Claims in Cases of Transferred Assets.*—The amount for which a transferee of the property of a taxpayer is liable, at law or in equity, and the amount of the personal liability of a fiduciary under section 3467 of the Revised Statutes, as amended (paragraph 81 of the Appendix to these regulations) in respect of any income tax imposed by Chapter 1, whether shown on the return of the taxpayer or determined as a deficiency in the tax, shall be assessed against such transferee or such fiduciary, as the case may be, and collected and paid in the same manner and subject to the same provisions and limitations as in the case of a deficiency in a tax imposed by chapter 1, except as hereinafter provided. The provisions relating to delinquency in payment after notice and demand and the amount of interest attaching because of such delinquency, the authorization of distraint and proceedings in court for collection, the prohibition of claims for abatement and claims and suits for refund, the filing of a petition with The Tax Court of the United States, and the filing of a petition for review of The Tax Court's decision, are included in the sections of the Internal Revenue Code (and regulations pertaining thereto) relating to deficiencies in tax imposed by chapter 1.

The term "transferee" as used in this section includes an heir, legatee, devisee, distributee of an estate of a deceased person, the shareholder of a dissolved corporation, the assignee or donee of an insolvent person, the successor of a corporation, a party to a reorganization as defined in section 112, and all other classes of distributees.

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